ECONOMIC UPDATE

REGIONS

June 13, 2018

June FOMC Meeting: To Neutral . . . And Beyond

- The FOMC raised the Fed funds rate target range by 25 basis points, taking the mid-point to 1.875 percent
- The updated "dot plot" implies a total of four 25-basis point hikes in the target range mid-point in 2018, three in 2019, and one in 2020

Clearly, Buzz Lightyear was better suited to be a Space Ranger than to be a central banker but that hasn't stopped many FOMC members from channeling his spirit, at least based on their latest economic and financial projections. As expected, the Committee shifted the Fed funds rate target range up by 25-basis points at the conclusion of their two-day meeting, putting the mid-point at 1.875 percent. Unlike infinity, however, you can actually go beyond neutral, and the revised dot plot shows the Committee expects to do just that, i.e., to push the funds rate to its estimate of neutral at some point in 2019 and then go beyond that. The updated "dot plot" implies a total of four 25-basis point funds rate hikes for 2018, up from the three hikes implied by the prior six editions of the dot plot, with three additional hikes in 2019 and one in 2020. At the same time, the median estimate of the "neutral" funds rate target range mid-point has not changed, remaining at 2.875 percent.

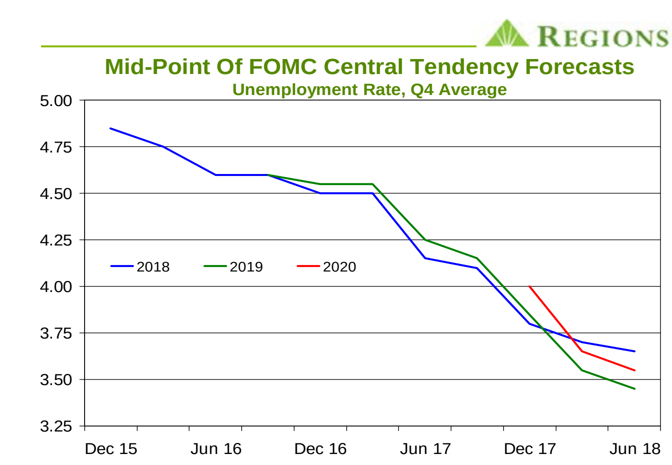
The Committee's assessment of current economic conditions shows only a few modest changes. Chairman Powell, in his press conference, described the economy as "doing very well" and noted that remaining on a course of gradually normalizing interest rates is the best way the FOMC can help ensure the current expansion endures. The forward guidance included in the post-meeting statement was changed; the passage noting that the Fed funds rate "is likely to remain, for some time, below levels that are expected to prevail in the longer run" was dropped, as was expected. One change on the horizon is that, beginning in January 2019, Chairman Powell will hold a press conference after each FOMC meeting, though he took care to note that twice as many press conferences does not imply a more aggressive policy stance.

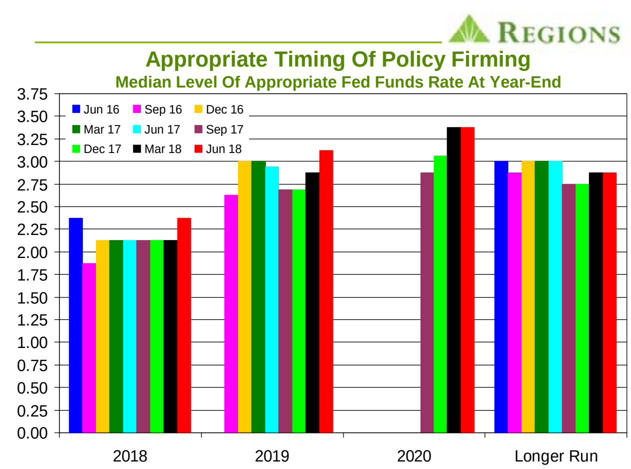
The updated economic projections are little changed from those issued in March. Expected 2018 Q4/Q4 real GDP growth and PCE inflation were revised marginally higher, but estimates for 2019 and 2020 were not changed. What is notable is that the Q4 average unemployment rate expected in 2018, 2019, and 2020 was revised lower relative to the March projections but the "longer run" (or, full employment) rate remains at 4.5 percent, meaning that the Committee expects that in Q4 2019 the unemployment rate will be 100 basis points below the rate consistent with full employment.

Another notable element of the updated projections is that the estimate of the economy's longer-run "potential" growth rate remains unchanged at 1.9 percent. This implies no boost from the 2017 tax bill despite expectations the bill will foster stronger growth in business investment spending. In his press conference, Chairman Powell noted there is a good deal of uncertainty as to what potential growth is and that it is too soon yet to have seen evidence of any impact on capital spending. Instead, the Committee will "watch and see" whether stronger business investment will fuel the faster growth in labor productivity that would lift the economy's potential growth rate.

With the shift of one Committee member from the three-hike camp into the four-hike camp, the median year-end 2018 dot now implies a total of four rate hikes this year, and the updated dot plot implies another three hikes in 2019. At the same time, however, the updated dot plot implies only one further rate hike in 2020 while the past edition implied two hikes. As a result, the median year-end 2020 funds rate is unchanged despite the extra hike added in 2018. But, the shift is still interesting particularly given that the updated dot plot puts the funds rate above neutral earlier than had been implied in earlier dot plots. This is one element of the Committee's projections that could worry market participants given past episodes of the policy rate overshooting its neutral value which have not ended well.

As Chairman Powell himself has noted before, one should be wary of putting too much weight on a forecast that far (i.e., 2020) down the road. If there is one point that has come across clearly from Chairman Powell in his short time at the helm, it is that he is not rigidly tied to any particular forecast and recognizes the inherent uncertainty attached to any forecast. In other words, while "data dependent" has in the past been little more than a central bank catchphrase, Chairman Powell seems quite comfortable in using that as an actual guide to policy.





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